

MEMORANDUM

To: Commissioners, EGG

From: Denise Peterson and Will Rosquist

Date: 3/15/01

Re: D97.7.90: MPC's Public Utility Obligations Pending Final Order on Transition Plan

BACKGROUND

On June 20, 1997 in Docket No. D97.7.90, the Montana Public Service Commission (Commission) issued Order No. 5986, Procedural Order, directing Montana Power Company (MPC) to file a utility restructuring and plan for transition to customer choice, pursuant to Senate Bill 390 (1997), codified at Title 69, Chapter 8, Montana Code Annotated (MCA).

MPC filed its Electric Restructuring Transition Plan (Plan) with the Commission on July 1, 1997. The Commission issued and published a Notice of Transition Plan Filing and Intervention Deadline on July 3, 1997, and numerous parties intervened in Docket No. D97.7.90.

The Commission issued its Preliminary Determination and Order on Transition Plan, Order No. *5986b*, on August 15, 1997. The Commission determined that the Plan must be transparent in terms of addressing the requirements of the Act and should contain all the basic information needed to evaluate the filing, including quantitative and qualitative analyses and documentation of methods used.

The Commission determined that MPC's Plan filed July 1, 1997 was incomplete and inadequate on MPC's customer education proposals and pilot programs and stranded costs. The Plan did not adequately analyze and document stranded costs, including (1) the estimation of future market values of electricity and the embedded costs of generation assets and liabilities and supply related costs, 2) consideration of the net value of production capability, and (3) demonstration and quantification of mitigation.

The Commission further determined that MPC's Plan was incomplete and inadequate with respect to the transfer of generation assets from rate base, including a complete analysis of the revenue requirements of all assets to be transferred and documentation and quantification of any mitigation savings. The Commission also found that the Plan failed to functionally separate electricity supply, retail transmission and distribution, and regulated and unregulated energy services.

On August 26, 1997, MPC filed its Revised Plan, captioned Supplemental Material to its Electric Restructuring Transition Plan Filing. In mid-November, 1997, Intervenors filed Direct Testimony pursuant to the Procedural Order and Schedule, as amended.

MPC announced on December 9, 1997 its intention to offer for sale its generation assets in Montana. On January 7, 1998, the Commission issued its notice setting the procedural schedule and revising the hearing date. The Commission rescheduled the hearing in two tiers, first addressing non-sale related issues on April 28, 1998, with a final order due on or before June 24, 1998, implementing first tier issues, in particular large customer choice on and after July 1, 1998.

MPC filed Rebuttal Testimony on January 30, 1998, and Intervenor filed Response Testimony on March 17, 1998. In Rebuttal Testimony, MPC stated that it intended to require from those bidding on the generation assets an agreement that the successful buyer(s) would enter into a contract with MPC's distribution unit to sell power to the distribution unit at a price of 21 mills/kWh during the transition period. Response testimony raised the question of whether this requirement would reduce the bid values for the assets. On April 1, 1998, the Commission issued a Notice of Issue of 21 -Mill Buy-Back on Sale of Generation and requested parties to file comments on the buy-back proposal by April 10, 1998.

On April 6, 1998, the Commission issued its Notice of Public Hearing on the first of two hearings (Tier 1 and Tier 2) scheduled on MPC's Transition Plan, Tier 1 to begin on April 28, 1998. The Commission determined that after the results of the sale of MPC's generation become known, the Commission would conduct a later hearing (Tier 2) on transition costs, market power, universal system benefits charge, revenue requirements, and the sale of MPC's generation assets. On April 13, 1998, MPC filed a Motion for Clarification, maintaining that the Notice of Public Hearing should be amended to reflect MPC's request for interim recovery of the hydrothermal assets, regulatory assets and qualifying facility contracts. MPC proposed that customers leaving the system on July 1, 1998 should pay these costs.

On April 17, 1998, the Commission issued the Notice of Commission Action Clarifying Public Notice. The Commission denied MPC's position that a request for Competitive Transition Charges (CTCs) is appropriate as a first tier issue at the hearing beginning April 28, 1998. The Commission determined that § 69-8-211, MCA, precludes recovery of transition costs before the

transition costs have been determined, based on an affirmative showing by the public utility of all reasonable mitigation of costs.

On April 20, 1998, MPC requested reconsideration of the Commission's denial of presentation of evidence on interim CTC recovery, on the grounds of (1) alleged due process violations; and (2) the Commission's alleged failure to consider verifiable costs during the "Interim Sale Period." MPC maintained that it should be able to recover verifiable costs from customers who leave MPC's system on July 1, 1998. Further, MPC said that Senate Bill 390 did not address the timing of a sale *vis a vis* the July 1, 1998 deadline. "[T]he statute doesn't require a '[p]ublic utility to divest itself of any generation asset or prohibit a public utility from divesting itself voluntarily of any generation assets.'" MPC maintained that a generation sale could happen years later, and the "result would have to be factored into the CTC recovery that had been in place in the meantime." (MPC's Motion, page 4.)

MPC requested that the Commission reverse its decision and allow MPC to present evidence regarding the transition costs MPC would incur during the Interim Sales Period. Alternatively, MPC asked to be able to collect these costs during the Interim Sale Period; or to accumulate these costs in an appropriate accounting order. In its Order Denying Reconsideration issued April 23, 1998, the Commission determined that MPC would not be harmed, because the large customers would be properly assessed their share of costs in the Commission's final order on transition costs after the Tier 2 proceeding. An accounting order to track and accumulate costs incurred during the Interim Sales Period would afford MPC full protection and due process.

The Commission determined that by law it could not grant a request to collect transition costs preceding the Commission's Final Order on the transition plan. Section 69-821 1(1), MCA, provides that the Commission shall allow recovery of the unmitigable costs of (1) qualifying facility contracts for which the contract price of generation is above the market price for generation; (2) energy supply-related regulatory assets and deferred charges that can be accounted for up to the effective date of the final order on the transition plan; (3) transition costs related to public utility owned generation and other power purchase contracts; as well as (4) other qualifying transition costs. The Commission determined that it could not allow recovery of these costs until after demonstration in the final hearing of the costs and mitigation. The Commission allowed MPC to propose an accounting order mechanism and make a limited presentation to support its proposal in the Tier 1 proceeding beginning April 28, 1998.

The Commission determined that a final order on transition costs under § 69-8-2 1 1(2), MCA, must be based on an affirmative showing by the utility, reflecting reasonable mitigation and a demonstration of the value of all generation-related assets and liabilities and electrical supply costs on a net basis. Under § 69-8-21 1(3)(a), MCA, “on Commission approval of the amount of a public utility’s transition costs, those costs must be recovered through the imposition of a transition charge.”

On April 27, 1998, the Commission issued a Notice informing MPC that the Commission would not require MPC to eliminate the buyback provision, or other provisions, from its generation asset offering. The Commission stated that if MPC required the purchaser of the generation facilities to enter into the 21 mill buy-back contract, MPC would have the burden of demonstrating in the Tier 2 proceeding that the requirement did not negatively affect the valuation of the generation facilities. On May 6, 1998, MPC filed Motion for Reconsideration of PSC’s April 27 Notice of Burden of Proof on the 21 mill buy-back provision asserting that the Commission’s notice places an undue burden on MPC. On May 20, 1998, the PSC issued a Notice of Commission Action denying MPC’s Motion for Reconsideration. The PSC found that its April 27 notice simply advises MPC of obligations that are imposed by SB 390

Beginning April 28, 1998, the Commission conducted a public hearing on the first tier issues of large customer choice on or after July 1, 1998; accounting order proposals; customer education and protection; pilot programs; and methods to select electricity suppliers. The Commission issued Order No. 5986*d* on Tier 1 Issues, on June 23, 1998. The Commission postponed setting the final hearing on the stranded cost and competitive bid sale issues, pending receipt of information on MPC’s competitive bid process.

On July 13, 1998, MPC requested reconsideration of Order No. 5986*d* in part on the issue of the standards of conduct addressing affiliate interaction between MPC’s electric transmission and distribution companies and other utility affiliates. MPC alleged that the Commission misinterpreted Title 69, Chapter 8, MCA, and “violated basic economic and antitrust principles by protecting competitors ...instead of consumers. -MPC maintained that the standards of conduct ordered by the Commission would protect MPC’s competitors and harm MPC and its affiliates.

On September 10, 1998, the Commission issued Order 5986*e*, Order on Reconsideration. The Commission determined that in Order 5986*d* it correctly interpreted § 69-8-204, MCA, and

that the adopted standards appropriately applied to the conduct of MPC's regulated electric utility functions. That conduct involved the prices, terms and conditions of access offered to all customers, including any affiliate, to regulated utility systems, facilities and services. Clear separation of regulated utility functions and other corporate functions would promote nondiscriminatory access to utility systems, facilities and services and prevent self-dealing.

The Commission conducted a public hearing on the single issue of the Universal System Benefits Charge ((JSBC) on October 7, 1998. The final hearing (Tier 2) would be set later to address transition costs, revenue requirements and the competitive bid sale of MPC's generation assets. On December 23, 1998, the Commission issued Order S986f authorizing MPC to implement an universal system benefits tariff including rates which would collect \$8,559,615 annually to fund Universal System Benefits Programs. On February 4, 1999, the Commission issued Order 5986g allocating the USBP funds to various public purposes and the implementation the programs.

MPC filed its application with the Commission for approval of the Tier 2/Generation Sale Issues of its transition plan to customer choice and electric industry restructuring pursuant to Senate Bill 390 (1997) on July 1, 1999. The Commission issued Order No. 5986j (Tier 2 Procedural Order), based on a closing date of September 1, 1999 (§ 2 e) for the sale of MPC's generation assets on July 6, 1999. The Commission stated that if the sale closing were delayed, the Commission could adjust the dates on its own motion or at the request of parties. On August 30, 1999, MPC informed the Commission that MPC anticipated the closing of the sale of the generation assets to occur in mid- to late October, 1999, and the Commission suspended the Procedural Schedule on the Tier 2 issues. The Commission required briefing of legal issues in the Tier 2 proceeding to forestall problems and legal challenges on the Commission's jurisdiction and implementation of Title 69, Chapter 8, MCA. The briefs were to address whether MPC's proposal for tracking mechanisms after the Final Order on the transition plan complies with Senate Bill 390, and whether market power and MPC's revenue requirement are relevant issues that must be addressed in the Tier 2 proceeding. In Order No. 5986m issued on November 16, 1999, the Commission determined that MPC had to amend its transition plan filing on the Tier 2 issues, excluding its proposal to track and adjust transition costs after the Final Order. MPC requested reconsideration. At a duly noticed work session on January 19, 2000, the Commission denied MPC's Motion for

Reconsideration and affirmed in Order No. 5986*n* the decision on the issue of tracking transition costs. This decision is on appeal at the Montana Supreme Court.

On December 17, 1999, MPC closed on the sale of its generation assets to PPL Montana. Pursuant to § 69-8-204(2), MCA, the Commission could neither order nor prevent MPC from selling its generation assets. Therefore, the Commission did not initiate a proceeding to evaluate whether the sale of the generation assets was in the public interest, as it normally does in cases involving sales of public utility assets.

On January 6, 2000, MPC filed a request with the Commission for an interim rate reduction to remove generation-related regulatory assets from rates. MPC stated that MPC's sale of its generation assets and certain purchase power contracts to PPL on December 17, 1999, produced a sufficient level of above-book proceeds to allow for the elimination of all generation related regulatory asset costs. In Order No. 5986*o*, the Commission approved MPC's request to reduce rates, on an interim basis, to reflect the elimination of generation related regulatory assets.

In approving the interim rate reduction, the Commission did not prejudge the overall level of regulatory asset-related transition costs that MPC may be entitled to recover. The amount of regulatory asset-related transition costs will be determined in the Tier 2 phase of this case and addressed in the Commission's final order. The Commission determined that MPC no longer required an accounting order to account for revenues associated with these regulatory asset costs for customers who have opted for choice. Further, no need existed to collect these costs in the rates of customers who continued to receive bundled MPC service. MPC had previously stated that proceeds in excess of book value would be returned to customers. The level of regulatory asset costs inherent in current rates was \$16,722,212.

On August 24, 2000, Montana Power Company (MPC) requested an increase in the generation component of retail rates to allow recovery of increased Qualifying Facility-related (QF) supply costs. For customers that have moved to choice, MPC also proposed implementing a new or modified accounting order. MPC stated that timely regulatory action could take the form of interim approval as part of Docket No. D97.7.90.

The Commission requested and received written comments on MPC's proposed rate increase. On November 8, 2000, the Commission issued Order No. 5986*r* denying MPC's request to increase rates on an interim basis. The Commission found that MPC had not

sufficiently justified the requested interim increase and raised concerns about MPC's mitigation of QF costs pursuant to its obligations under Senate Bill 390.

DISCUSSION

MPC has been and continues to be a public utility regulated by the Commission pursuant to Title 69, Chapter 3, Montana Code Annotated (MCA) ("Chapter 3," "Regulation of Utilities"), providing a full electric service to approximately one—quarter million Montana ratepayers. MPC in every respect to this date meets the definition of a "public utility" in Chapter 3, in owning, operating and/or controlling plant or equipment within the state for the production, delivery and furnishing electric utility service to others, as set forth in § 69-3-101, MCA.

Under Chapter 3, the Commission has full supervisory and regulatory authority over MPC's rates and service, and matters ancillary to the provision of electric service addressed throughout Chapter 3. § 69-3-401, MCA. MPC has the public utility obligation to provide reasonably adequate service at reasonable rates approved by the Commission. § 69-3-201, MCA.

The Montana Legislature in 1997 passed Senate Bill 390, codified at Title 69, Chapter 8, MCA ("Chapter 8," "Electric Utility Industry Restructuring"). In § 69-8-102(3), MCA, the legislature declared as policy that the interests of Montana consumers should be protected and the financial integrity of electrical utilities should be fostered. The legislature particularly determined in § 69-8-102(4), MCA that the public interest requires the continued protection of consumers.

Chapter 8 establishes obligations for electric public utilities, e.g., MPC, which are required to restructure their business and functionally separate their utility functions under the Chapter. Section 69-8-102, MCA, requires MPC to file a transition plan. Section 69-8-208, MCA, requires MPC as the distribution services provider to build and maintain distribution facilities and be an emergency supplier of electricity and related services. Pursuant to § 69-8-401, MCA, MPC has the obligation to maintain standards of safety and reliability of the electric delivery system and existing customer service requirements. Section 69-8-210, MCA, provides that not until the effective date of the Commission's order implementing MPC's transition plan pursuant to § 69-8-202, MCA, can MPC remove its

generation assets from the rate base, which is MPC's investment in its fully integrated public utility property.

Section 69-8-210, MCA, establishes that MPC has electricity supply obligations during the transition period. The purpose of these obligations is to protect customers who do not have a choice or have not chosen an electricity supplier during the transition period. Due to the functional separation of MPC's generation assets, prices for regulated supply during the transition period could reflect either generation costs or market prices. But in either case, the purpose is customer protection through cost-based (just and reasonable) rates.

At this time MPC has not received the approval of the Commission to transfer the generation assets out of rate base. MPC is providing public utility service with the obligation to obtain supply pursuant to Chapter 3. The Commission has ongoing regulatory and supervisory authority over MPC pursuant to Chapter 3, including the generation component that has not been sanctioned under Chapter 8 as functionally separated from the distribution and transmission functions of public utility service.

As well as retaining its authority under Chapter 3, the Commission also has ongoing authority over MPC in implementing Chapter 8, in considering MPC's application for approval of its transition plan, and after the final order. § 69-8-403, MCA. The Commission has not held the final hearing or issued the final order on the plan, which will transfer the generation assets out of rate base. Section 69-8-211(6), MCA, prohibits "public utilities" that are restructuring, e.g., MPC, from raising rates through July 1, 2002 for customers with loads less than 1000 kilowatts. In any case during the transition period, rates may not be higher than what the regulatory system would have produced. Therefore, MPC continues to provide a full public utility service to those customers who have not opted to choice, on rates the Commission previously determined under Chapter 3 to allow a rate of return on MPC's investment in its utility property, including its generation assets sold to PPL Montana.

Beginning on, and hence thereafter, the effective date of the Commission's order on the transition plan, the Commission will continue to regulate MPC's transmission and distribution services as ongoing public utility functions, but will not regulate the price of competitive electricity supply. § 69-8-403, MCA. However, the Commission has the authority to regulate the price of electricity supply provided during the transition period (1) by default suppliers for

customers not served by a competitive supplier or (2) by the distribution function of a public utility (Id.). The Commission must regulate service and establish just and reasonable rates through established ratemaking principles for public utility distribution services (69-8403(5), MCA). Default electricity supply is a distribution service during the transition period, because it is a service provided by the distribution utility.

MPC's plan for relying on cost-based prices or market-based prices during an extended transition period is an issue that must be addressed in the hearing on MPC's transition plan, and the Commission has the authority to modify or deny MPC's transition plan. § 69-8-202, MCA. MPC sold its generation assets before the Commission could act on MPC's transition plan and entered into a buyback contract with the purchaser PPL Montana. The buyback contract did not provide for the possibility that the Commission could exercise its authority to determine cost-based, just and reasonable rates during a transition period that could be extended by the Commission after the rate moratorium in § 69-8-21 1(6), MCA. MPC's completion of the generation sale before the Commission's final order on the transition plan and the provisions of the PPL buyback contract cannot preclude the Commission from determining cost-based prices that should be used to protect customers during the extended transition period

In Senate Bill 390 (69-8-101, et seq. MCA), the Legislature sought to transform Montana's electric utility industry from one in which electricity is supplied to retail customers by a monopoly public utility, to one in which electricity is supplied by competitive companies. However, the concept of regulated public utilities (electricity) was not eliminated with the passage of Senate Bill 390, particularly during the transition period. Title 69, Chapter 3, MCA, remains in effect. Section 69-3-101(1), MCA, defines the term "public utility" to include every corporation that owns, operates or controls any plant or equipment or any part of a plant or equipment within the State used to produce, deliver or furnish power. Section 69-3-102, MCA gives the Commission full power to supervise, regulate and control public utilities. Section 69-8-103(23), MCA defines public utility as any public utility regulated by the Commission on May 2, 1997, including the public utility's successors and assignees.

In § 69-8-102(3), MCA, the legislature declared as policy the need to protect the interests of Montana consumers during the industry transition. The legislature maintained

regulated public utility supply obligations during the transition period as a foundation of consumer protection.

The Commission retains ultimate authority over public utilities transitioning from monopoly supply to competitive supply. A transitioning public utility is required to submit a transition plan to the Commission. The public utility's transition plan must demonstrate that the utility has fully complied with all requirements in § 69-8-101, et seq. MCA. The Commission has final authority over a public utility's plan to implement the transition, including the authority to deny the entire plan or modify it to satisfy the public interest. § 69-8-202, MCA. Upon approval of a transition plan, the Commission is empowered to enforce any public utility obligations pursuant to the Commission's Final Order approving the plan. A public utility's plan for satisfying its regulated supply obligations during the transition period must be acceptable to the Commission before the Commission grants final approval to the public utility's transition plan.

Crucial to the legislature's design for protecting consumers during the transition period is the requirement that the Commission grant final approval to a public utility's transition plan before the public utility removes its generation assets from the regulated rate base. Section 69-8-210, MCA, states that a public utility shall remove its generation assets from rate base "on the effective date of a commission order implementing" the transition plan. A public utility's generation assets, or some surrogate thereof, must remain in the regulated rate base until the Commission issues its Final Order on the transition plan. The Final Order is the mechanism the Commission uses to establish the public utility's supply obligations during the transition period and is the means of fulfilling the legislature's requirement to protect the interests of consumers during the transition.

The legislature envisioned that a public utility could sell its generation assets. Section 69-8-204(2), MCA explicitly states that the Commission can neither order nor prevent a public utility from selling any generation assets. However, if the public utility sells its generation assets before the Commission issues a final order on the public utility's transition plan, those assets must necessarily be held in trust, as regulated public utility assets, by the purchasing company until the Commission issues the Final Order. If this were not the case, then a public utility could not sell its generation assets prior to receiving a Final Order from the Commission on its

transition plan, which would allow the transfer of the generation assets from rate base. The Legislature did not intend the divestiture of the assets, as one means of functionally separating and determining value of the generation assets, to deprive the Commission of the authority to make determinations on the generation before the final order. There is no other way for the Commission to properly exercise its authority to ensure the protection of consumers during the transition period.

RECOMMENDATION

The Commission should affirm the jurisdiction that the Commission continues to exercise over Montana Power Company (MPC) as a regulated public utility pursuant to Title 69, Chapter 3, MCA, providing fully regulated utility service of generation, transmission and delivery of electricity to its ratepayers. The Commission continues to have full supervisory and regulatory authority over MPC's rates and service.

The Commission has additional duties to implement MPC's restructuring/transition plan filed pursuant to Title 69, Chapter 8, MCA, and has ongoing authority during the transition. Only the Commission in its final order on MPC's transition plan can transfer those generation assets held by MPC on May 2, 1997, or its successors or assignees, out of MPC's rate base, as previously determined pursuant to Title 69, Chapter 3, MCA. Until the final order, MPC has the ongoing public utility obligation to furnish the electricity to its ratepayers as a fully integrated public utility. The generation assets, although transferred in title to PPL Montana, remain regulated public utility assets in MPC's rate base. The Commission retains the inherent regulatory authority under Title 69, Chapter 3, MCA, and the additional authority provided under Title 69, Chapter 8, MCA, to make determinations regarding these generation assets to protect customers during the extended transition period, while fostering the financial integrity of MPC.